

## **FISCAL NOTE**

### **SB 70 – HB 115**

February 6, 2007

**SUMMARY OF BILL:** Reduces the state sales tax rate on food from 6% to 3%. Increases the excise tax on cigarettes from 20 cents to 65 cents per pack. Increases the excise tax on cigarettes by 3 cents per pack each fiscal year beginning with FY07-08 and continuing until FY16-17.

#### **ESTIMATED FISCAL IMPACT:**

**Increase State Revenues – Net Impact - \$105,288,000 / Education Fund**

**Decrease State Revenues – Net Impact**

**\$67,533,000 / General Fund**

**\$11,223,000 / Earmarked to Local Governments**

**\$855,000 / Department of Revenue**

**\$2,137,000 / Sinking Fund**

**Increase State Expenditures - \$220,000 Recurring**

**\$200,000 One-Time**

**Decrease Local Govt. Revenues – Net Impact**

**\$6,922,000 Recurring**

#### **Food Tax Assumptions:**

- According to the Department of Revenue, taxable sales of food and food ingredients in Tennessee for FY05-06 were approximately \$7,753,600,000.
- Based on historical collection patterns, taxable sales of food and food ingredients are estimated to grow by approximately 2.5% per year.
- Taxable sales for FY07-08 are estimated to be approximately \$8,146,126,000.
- The recurring decrease in state sales tax revenue resulting from a one-time 3% rate reduction for food sales is estimated to be \$244,384,000 ( $\$8,146,126,000 \times 3\% = \$244,383,780$ ) per year.
- The estimated \$244,384,000 in state sales tax revenue would have been apportioned as follows: \$70,931,000 to the General Fund,

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\$159,087,000 to education, \$11,223,000 to local governments, \$898,000 to the Department of Revenue (DOR), and \$2,245,000 to the Sinking Fund.

- The state will forgo additional sales tax revenue in subsequent fiscal years due to growth of taxable sales.
- Local governments are not held harmless from the loss of state-shared sales tax revenue.
- Local governments will lose approximately \$11,223,000 in state-shared sales tax revenue in FY07-08.

#### Cigarette Tax Assumptions:

- According to the DOR, excise tax collections on cigarettes in FY05-06 were approximately \$115,462,000.
- Current excise tax rate on cigarettes is \$0.20 per pack.
- Estimated number of packs sold in FY05-06 was 577,310,000 ( $\$115,462,000 \div \$0.20 = 577,310,000$  packs).
- Cigarette elasticity is determined from a variable elasticity schedule depending upon the extent of any excise tax increase.
- Cigarette elasticity rate for proposed increase is estimated to be -0.348.
- Current state sales tax rate on cigarettes is 7.00%.
- Local option sales tax rate on cigarettes is estimated to be 2.25%.
- Current consumer price per pack is estimated to be \$3.19 per pack (excluding sales tax); \$3.49 per pack (including sales tax).
- Increasing the excise tax on cigarettes by \$0.48 per pack (\$0.45 one-time + \$0.03 annual = \$0.48 increase in FY07-08) would also generate an additional \$0.04 per pack in state and local option sales tax revenue ( $\$0.48 \times 9.25\% = \$0.044$ ).
- The total price increase to the consumer is estimated to be \$0.52 per pack ( $\$0.48$  excise tax increase +  $\$0.04$  incremental sales tax =  $\$0.52$ ).
- Consumer price per pack after the proposed excise tax increase is estimated to be \$3.67 per pack (excluding sales tax); \$4.01 per pack (including sales tax).
- Increasing the excise tax on cigarettes would increase the price per pack to the consumer by an estimated 14.9% ( $\$0.52 \div \$3.49 = 14.9\%$ ).
- Quantity demanded would decrease by an estimated 5.185% ( $14.9\% \text{ price increase} \times -0.348 \text{ elasticity rate} = -5.185\%$ ).
- Quantity demanded in FY07-08 is estimated to be 547,376,500 packs ( $577,310,000 \times \{100.00\% - 5.185\%\} = 547,376,477$ ).
- Total excise tax collections are estimated to be \$372,216,000 ( $547,376,500 \text{ packs} \times \$0.68 \text{ excise tax} = \$372,216,020$ ) in FY07-08.
- Incremental excise tax collections are estimated to be \$256,754,000 ( $\$372,216,000 - \$115,462,000 = \$256,754,000$ ) per year.

- 100% of the estimated \$256,754,000 in incremental excise tax collections would be apportioned exclusively for public education, grades one through twelve.
- Excise tax collections would grow in subsequent fiscal years due to the additional excise tax rate increases proposed in this legislation.
- Sales tax collections will increase because sales tax is computed on the final retail sale (which includes any current and increased excise tax).
- Retail sales before the proposed excise tax increase are estimated to be \$1,841,618,900 (577,310,000 packs X \$3.19 old price (excluding sales tax) = \$1,841,618,900).
- Retail sales after the proposed excise tax increase are estimated to be \$2,008,872,000 (547,376,500 packs X \$3.67 new price (excluding sales tax) = \$2,008,871,755).
- Incremental retail sales are estimated to be \$167,253,100 (\$2,008,872,000 - \$1,841,618,900 = \$167,253,100).
- Incremental state sales tax revenue is estimated to be \$11,708,000 (\$167,253,100 X 7% state rate = \$11,707,717) per year.
- The \$11,708,000 in incremental state sales tax revenue would be apportioned as follows: \$3,398,000 to the General Fund, \$7,621,000 to education, \$538,000 to local governments, \$43,000 to the DOR, and \$108,000 to the Sinking Fund.
- The net recurring increase to state revenues resulting from incremental state sales tax collections is estimated to be \$11,170,000 (\$11,708,000 - \$538,000 local share = \$11,170,000) per year.
- Additional sales tax revenue will result (for both state and local governments) in subsequent fiscal years due to the additional excise tax rate increases proposed in this legislation.
- The total net recurring increase to state revenues resulting from the increased excise tax is estimated to be \$267,924,000 (\$256,754,000 from additional excise tax + \$11,170,000 from additional sales tax = \$267,924,000) per year.
- Incremental local option sales tax revenue is estimated to be \$3,763,000 (\$167,253,100 X 2.25% local option rate = \$3,763,195).
- The total net recurring increase to local government revenues resulting from the increased excise tax is estimated to be \$4,301,000 (\$3,763,000 in local option tax revenue + \$538,000 in state-shared sales tax revenue = \$4,301,000).

#### Other Assumptions:

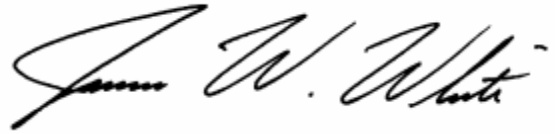
- The legislative intent of this act is that the fiscal impact of this bill be at least revenue-neutral.
- If the amount of cigarette tax revenue generated by the excise tax rate increase is not sufficient to cover the loss of revenue resulting from the

decreased sales tax rate on food, then the cigarette tax shall be increased by an amount necessary to offset such net loss of revenue.

- If the amount of cigarette tax revenue generated by the excise tax rate increase exceeds the loss of revenue resulting from the decreased sales tax rate on food, then such additional revenue shall be applied either to the establishment of a food tax holiday prior to Thanksgiving or a further rate reduction of the sales tax on food.
- Three additional Regulatory Officers in the DOR will be required to combat the illegal importation of cigarettes into Tennessee.
- Security upgrades will be required for cigarette tax stamps to combat illegal/counterfeit tax stamps.
- The recurring increase to state expenditures for the new positions and tax stamp enhancements is estimated to be \$220,000 per year.
- The one-time increase to state expenditures for computer and software enhancements and for costs associated with hiring the three Regulatory Officers is estimated to be \$200,000.
- The total net recurring increase to state revenues resulting from this legislation is estimated to be \$23,120,000 (\$267,924,000 increase generated from additional excise tax on cigarettes - \$244,384,000 decrease from lower sales tax on food - \$420,000 one-time/recurring expenditures = net increase of \$23,120,000) per year.
- To achieve the revenue-neutral intent stated in Section 3 of this legislation, the following would be necessary: (1) An excise tax equal to 66 cents per pack (or 3.30 cents per cigarette) in FY07-08, (2) a provision holding local governments harmless from the loss of any state-shared sales tax revenue, and (3) additional one-cent excise tax increases in subsequent years beginning in FY08-09.
- The incremental excise tax revenue generated from subsequent one-cent tax increases would be sufficient to offset any incremental decrease of state sales tax revenue that would have occurred from growth of taxable food sales.
- The total net recurring decrease to local government revenues resulting from this proposed legislation is \$6,922,000 (\$11,223,000 decrease from lowering the sales tax on food + \$4,301,000 increase from increasing excise tax on cigarettes = net decrease of \$6,922,000) per year.

## **CERTIFICATION:**

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.

A handwritten signature in black ink, reading "James W. White". The signature is written in a cursive style with a large, stylized "J" and "W".

James W. White, Executive Director